IN THE

Supreme Court of the United States

OCTOBER TERM, 1964.

No. 245

WATERMAN STEAMSHIP CORPORATION,
Petitioner.

vs.

UNITED STATES OF AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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Introduction.

In the Opinion of the Trial Court in this case, 203 F. Supp. 915 (1962), the Trial Court observed (p. 929): "It seems to me that the Internal Revenue Service is attempting to create confusion in an area where Congress has been most explicit in setting forth the statutory procedure." After studying the Brief for the United States filed in this cause, one can better appreciate this statement. Seizing on one phrase in the statute and ascribing to it a use and purpose not only contrary to explicit provisions elsewhere but quite different from the scheme of the law as a whole and dividing the single statutory formula for adjustment in price into different parts, without any basis in the statute, the Government has now compounded the confusion initially

begun in the Delaware Court and continued in the Courts of Appeals for the Third and Fifth Circuits.

Under "Question Presented" on page 2 of the Brief for the United States, the legal issue is properly established. However, by page 11 of that Brief, the issue has been subtly changed and now the Government states that "The precise question in this case is whether taxpayer was to be put in the same position *for federal income tax purposes* as if it had purchased its vessels under the Act rather than before the Act." (emphasis in original). This might be the question which the Government would like to have the Court accept as the issue, but there is nothing in the Act to lead to this conclusion. Waterman received *an* (just one) adjustment in purchase price for the 18 vessels purchased by it prior to the Act. This adjustment was computed by one indivisible statutory formula with several factors and computations but with one single result. The issue presented by the Briefs of the Parties resolves into whether Section 9 requires one adjustment, as contended by Petitioner, or three adjustments, as contended by Government (Government Brief at p. 4). The effect of this difference is whether the tax cost basis of the vessels is the actual economic investment in the vessels, as contended by Petitioner, or the artificial statutory sales price, as contended by the Government.

Avoiding the appealing, but impractical, approach of an erroneous-point-by-erroneous-point answer to the Government's Brief, Petitioner restricts its Reply Brief to the following points: Section 9 of the Act provides for a single adjustment in a purchase price of a vessel by a specific and detailed statutory formula. Section 9(c)(1) of the Act is a part of the statutory formula and implements the single adjustment under Section 9(b). The Government's proposed construction would misread and misinterpret the

purpose and effect of that Section and particularly its alternative argument as to its effect misinterprets Petitioner's construction thereof. Finally, the Government all but abandons the recourse to the legislative history of the Act, which was the primary basis of the decisions of the lower courts in its favor.

ARGUMENT.

1. Section 9(b) of the Act provides for a single adjustment in the purchase price of a vessel by a specific and detailed statutory formula.

(a) Government's proposed construction ignores clear language of Section 9(b).

The basic difference between Petitioner and the United States, and the basic fallacy in the Brief filed by the latter, is whether or not the specific language of Section 9(b) of the Act is to be followed in making *the* price adjustment and in giving to *such* adjustment its normal tax effect. The Government seizes on one phrase in Section 9(b) of the Act ("by treating the vessel as if it were being sold to the applicant on the date of enactment of this Act, and not before that time") and weaves a tenuous theory of multiple adjustments and multiple tax effects. It argues that this phrase establishes the purpose of Section 9 of the Act and, regardless of the language immediately preceding and immediately following in that section, results in the federal income tax effect sought by the Government. In so doing, the Government conveniently overlooks (1) the specific language immediately preceding and immediately following the above-quoted phrase to the effect that "*Such adjustment* shall be made *as hereinafter provided*", and that "The amount of such adjustment shall be determined *as follows*" (emphasis added) and, (2) that the phrase

merely sets the *time* as of which the adjustment formula thereafter provided shall be computed. Phrases such as "as of such date of enactment," "with the date of enactment of this Act," and "prior to the date of the enactment of this Act", all have the same purpose as the phrase in the initial paragraph of Section 9(b), that of fixing the time as of which the computations will be made under the formula set out in the various subparagraphs under Section 9(b). Giving to that phrase this meaning and effect removes the conflict between the meaning and effect given to that phrase by the Government and the application of the statutory price adjustment formula set out in the numbered subparagraphs of Section 9(b).

The Government's proposed construction would ignore and violate the explicit statutory language and the precise statutory formula set out in Section 9(b). This section provides only *one* adjustment, which is "an adjustment in the price of such vessel", although there are several computations to be made under the formula in determining the amount of that adjustment. Contrary to the Government's position, subparagraphs (1) through (4) of Section 9(b) do not give a price adjustment. Subparagraph (1) simply provides for a credit to the applicant or to the Government,[1] just as do subparagraphs (5) and (6). Subparagraph (1) has no meaning nor effect without subparagraph (8), which nets the credits obtained in the preceding subparagraphs and directs the application or disposition of those credits. Only after application of subparagraph (8) does an Applicant know the adjustment provided for in Section 9(b). In separating subparagraphs

[1] The statute provides, in the latter case, that there will be a payment rather than a credit, but as pointed out previously, this has not been followed by Maritime in applying the Act. See Note 22 at p. 22 in Petitioner's original Brief and computation XIV at E-5 of Appendix E, of Appendices to Petitioner's original Brief with regard to National Bulk Carriers, Inc.

(1) through (4) from subparagraphs (5), (6) and (8), the Government completely ignores the language and structure of Section 9(b), which determines only one adjustment.

Typical of the loose language and loose application of the Section 9(b) formula is Schedule I on page 7 of the Government Brief. No such Schedule appears anywhere in the record in this case and it cannot be constructed from the language of any provisions of the Act. Line 1 in that Schedule speaks of "original purchase price" and lines 1 through 3 treat subparagraph (1) of Section 9(b) as if it requires a subtraction of the statutory sales price from the original purchase price, whereas, subparagraph (1) speaks only of crediting an applicant with an excess of cash payments made over 25% of the statutory sales price of the vessel. Nowhere in the Act, nor in the Interim or Final Agreements does one find the term or the computation leading to a so-called "gross price adjustment". The Government then speaks of charter hire "returned" to Maritime (line 4) and "refund" of taxes paid by Waterman (line 8) and "net credit in favor of Maritime" (line 9), all without any basis in the language or structure of the price adjustment formula, and concludes with a so-called "net payment to Waterman" (line 10), which, in effect, is *the adjustment in the purchase price* of the vessels. The Government cannot avoid this inevitable conclusion simply by labeling it as "net payment"[2] To have been consistent with its labeling of line 3 as "Gross price adjustment", the Government would have labeled line 10 in Schedule I as "Net price adjustment to Waterman," as contended by the Petitioner.

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[2] In fact no payment was made to Waterman. This net credit (or the excess of the "sum of the credits in favor of the applicant" over "the sum of the credits in favor of the Commission") was applied as a further adjustment in mortgage indebtedness from Waterman to the Government.

(b) Government's proposed construction confuses the factors in the price adjustment formula with a series of severable adjustments.

The Government's Brief constantly refers to "unwinding the actual pre-Act charter transactions and their federal income tax effects and substituting credits equivalent to different pre-Act transactions and tax effects" (see pp. 13-14). Again, however, this is another instance of the Government's confusion and its attempt to substitute for the Act adopted by the Congress, an act considered and rejected by the Congress, namely H. R. 3603 as amended in the Senate.[3]

H.R. 3063 as recommended by the Senate ("Senate amendment") incorporated the concept that the purchase of the vessel by the pre-Act purchaser would be recognized to have taken place at the time of the actual purchase. It would then proceed to make one computation in determining the amount of the adjustment in purchase price, considering and treating the vessel as having been purchased at that time at the statutory sales price instead of at the actual price originally paid.[4] In the light of this adjustment provision, Section 9(e)(1) of the Senate amendment (the "Tax Section") specified that the income and excess-profit taxes of the vessel owner for the taxable year within which the delivery of the vessel was made (the original purchase) and for subsequent taxable years were to be redetermined and for such purposes the vessel "shall be considered as having been acquired at the adjusted pur-

[3] See Appendix C, of Appendices of Petitioner's original Brief filed herein. See also opinion of Judge Madden in *Socony Mobil Oil Co.* v. *U. S.*, 287 F2d 910, 913, and dissenting opinion of Judge Cameron in *U. S.* v. *Waterman Steamship Corporation*, 330 F2d 128, 135.

[4] See Section 9(e) of the Senate amendment at C-3, Appendix C, of Appendices to Petitioner's original Brief filed herein.

chase price and the income and deductions attributable to such vessel shall be determined as if this section had been in effect on the date of such delivery." Section 9(d) of the Senate amendment ("Conditions Section") provided the liability of the Government for charter hire would have been limited to 15% of the adjusted purchase price from the date of the actual delivery and the depreciation from that date would have been computed on the adjusted purchase price.

Thus, under the Senate amendment there would have been (1) a change in the original purchase price and (2) an unwinding of the charter hire and depreciation with regard to that vessel for the period between the time of the original purchase and the time of the adjustment. This unwinding of charter hire and depreciation would have in nowise been involved in the computation of the adjustment in price and its only and actual function would result in an actual refund of charter hire to the Government and an actual refund or credit to the taxpayer on the recomputation of taxes as a result of the increase or decrease in taxable income from the refund of the charter hire, less the decrease in deductions as a result of the decrease in depreciation. This would have been a true unwinding of a previous transaction.

The Act as enacted contained no such "unwinding". Rather there is an adjustment in price (Section 9(b)), under a formula which provides for credits measured by hypothetical and actual transactions beginning with original purchase and ending with determination of the statutory sales price and including certain interim transactions, *all* of which are netted together in determining *the* adjustment in price. The fact that certain of these formula factors used in determining this one adjustment are *measured* by items resulting from hypothetical and actual trans-

actions, such as credits for charter hire (treated as having or not having been received), for interest (treated as having been received), and for overpayment or deficiency in taxes (treated as having been paid or refunded), does not change the effect of the netting together of these factors into a final adjustment in price. There is no unwinding of previous actual transactions and events, but rather a confirming of the original purchase at the original purchase price and a provision for making *an* adjustment in that purchase price pursuant to the formula. There is nothing in the language nor the structure of Section 9(b) to justify, or even suggest, a contrary construction or result.

The Government's division of the indivisible adjustment provided in Section 9(b) into (i) an adjustment provided by subparagraphs (1) through (4) and (7) and (ii) separate adjustments with independent tax effects for the remaining subparagraphs of Section 9(b), would be to transform a series of formula factors into "adjustments." This has the effect of revising the Act into the form of the rejected Senate amendment. Under the Senate amendment a computation such as is set out in lines 1 and 2 of Schedule I at page 7 of Government's Brief would have been proper. The adjustments and computations called for in lines 3 through 10 of the same Schedule would have followed under the provisions of Sections 9(c)(1) (except as to the amount of charter hire) and 9(e)(1) of that Senate amendment.

The Government's position that adjusted purchase price under subparagraphs (1) through (4) of Section 9(b) is equal to the statutory sales price under the Act is inconsistent with its administration of this Act under other circumstances. Section 509 of the Merchant Marine Act, 1936,[5] provides that not more than 87½% of the purchase price of a vessel may be secured by a mortgage. In

[5] 46 U. S. C. A. 1159.

the National Bulk Carriers, Inc. case, however, the sum of the mortgage indebtedness after adjustment in price plus the adjusted trade-in allowance (without regard to any cash payments made by applicant) exceeded the statutory sales price.[6] If the position of the Government in this case is correct, then the Government exceeded its authority in the adjusted mortgage indebtedness allowed to National Bulk Carriers.[7] Stated another way, if the Government's position is correct, the mortgage indebtedness of National Bulk Carriers included at least a part of its obligation to refund charter-hire to the Government. There is no statutory authority for any ship mortgage to cover any such indebtedness. On Petitioner's theory this additional indebtedness is a part of the purchase price and thus authorized by law.

2. Section 9(c)(1) of the Act is part of the statutory formula and implements the single adjustment under Section 9(b).

(a) The Government's proposed construction would misread and misinterpret the purpose and effect of Section 9(c)(1) of the Act.

The Government further confuses the issue by seeking to construe subparagraph (1) of Section 9(c) of the Act ("Conditions Section") to require a separate computation from that required in Section 9(b)(8), resulting in an independent tax effect in respect of each factor in the formula under Section 9(b).

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[6] See Computation XIV, E-5, Appendix E, of Appendices to Petitioner's original Brief filed herein.

[7] 87½%, maximum mortgage allowed, of $5,153,899.31, the purchase price, is $4,509,661.90. The mortgage indebtedness of $4,817,213.22 after adjustment was $307,551.32 greater than allowed by statute.

This construction would attribute to Section 9(c)(1) tax effects beyond its limited application. This subparagraph applies only to events occurring between the original purchase and the date of the adjustment (the date of the enactment of the Act) and does not reflect transactions beyond that date. The language of Sections 9(b) and 9(c)(1), when read together, make it clear that the tax effects prescribed by Section 9(c)(1) for certain steps in the adjustment computation are only for the purpose of determining the overpayment of or the deficiencies in federal taxes of the applicant in computing the final net credit in subparagraph (8) of Section 9(b). This limited use does not, however, change the net or final result of the application of all of the subparagraphs of Section 9(b) into something other than an adjustment in price to be treated like, and to have the tax effects of, any such adjustment in price would normally be treated, or have, under the Internal Revenue Code.

The obvious, indeed the only conceivable, purpose of the explicit provisions of Section 9(c)(1)[8] was to make clear that even though the formula factors making up the price adjustment are based upon hypothetical transactions, both Petitioner and Government must agree that for federal income tax purposes they will act subsequently to the adjustment in a manner consistent with the formula. Thus, hypothetical tax overpayments will for all time be treated as having been refunded and deficiencies, as having been paid.

The purpose of the agreement between the parties required by Section 9(c)(1) is to prevent either party, after having paid and received a price adjustment determined under a formula involving hypothetical and actual trans-

[8] See Government Brief at p. 23.

actions, from indirectly abrogating the adjustment by use of the tax law. For example, since Petitioner was credited with interest on a hypothetical investment under Section 9 (b)(5), Government could not indirectly negate a portion of this credit by later asserting an income tax deficiency against Petitioner on the theory it had constructively received such interest. Similarly, if Government received credit for charter hire previously paid by it under Section 9(b)(6), Petitioner could not later file a claim for refund of income tax on the theory that the charter hire had in fact not been received.

(b) The alternative argument of the Government of the effect of Section 9(c)(1) if Petitioner is correct is misleading and erroneous.

The alternative argument of the Government, beginning at page 25 of its Brief, is raised before this Court for the first time in this proceeding and again illustrates the complete absence of understanding of the purpose and effect of Section 9(c)(1) of the Act. The Government argues that if the conditions prescribed in subparagraph (1) of Section 9(c) do not have independent tax effects on the various computations set out in the numbered subparagraphs of Section 9(b), then it has no effect whatsoever, with the result that, contrary to Section 9(c)(1), the adjustment in price determined under Section 9(b) must be subtracted from the adjusted purchase price and not the original purchase price. As pointed out immediately above, Section 9(c)(1) has a definite, although limited, tax purpose and effect. After having attributed to Section 9(c)(1) tax effects that are not explicit or implicit in the Act, the Government now seeks to avoid entirely the explicit provisions of Section 9(c)(1).

It was stipulated and agreed that Petitioner's tax cost *basis* of the 18 vessels as of March 7, 1946, the day prior to the date of enactment of the Act, was $47,149,043.42, the original purchase price of these vessels less the adjusted basis of the four vessels traded in.[9] This stipulation follows the explicit provisions of Section 9(c)(1).

It is difficult to see how the Government can ignore the plain language of Section 9(c)(1), the agreement of the parties[10] and the stipulation incorporating its requirements, and seriously urge that the case be remanded in the event Petitioner's contention is upheld. This is only another example of the extreme position taken by the Government that the Petitioner and other taxpayers have been faced with in their contention that they should be entitled to a basis for depreciation purposes, of their actual economic investment in the vessels.

3. The Government all but abandons the recourse to the legislative history of the Act which was the primary basis of the decisions of the lower courts in its favor.

In support of its argument that "The legislative history is entirely consistent with the Government's view", the Government cites only (i) a general statement or conclusion in the Conference Report on the bill as enacted, and (ii) some general statements of Representative Jackson, who sponsored the last minute changes in Section 9 on the floor of the House, in explaining these highly technical and far-reaching changes. These were explained at length in their proper perspective in Petitioner's original Brief filed

[9] Par. 3, Pl's Exhibit F, R. 40-42.

[10] Article 8, Exhibit S-3, Plaintiff's Exhibit F, R. 40, 51, 59-60.

herein (beginning at page 43 and continuing through page 69), to which the Government has made no reply in its Brief. In fact the Government makes no attempt in its Brief to support the decisions of the Delaware Court and of the Fifth Circuit, the principle basis of which was the legislative history of the Act. This is particularly ironic and significant, since these were the first decisions supporting the Government's proposed theory and was the principal reason for their holdings.

Conclusion.

In conclusion, Petitioner respectively contends (i) that the argument of the Government to the effect that the numbered subparagraphs of Section 9(b) require separate adjustments with separate tax effects instead of factors or elements which are netted for one adjustment with one tax effect, is entirely fallacious and is supported by neither the language nor the structure of the Act; (ii) that the Government's treatment of the phrase "by treating the vessel as if it were being sold to the applicant on the date of the enactment of this Act" as evidence of the statutory purpose and in support of the conclusion that, without more, the basis of a pre-Act purchaser must be the basis of a post-Act purchaser is directly contradictory of the express language and formula of Section 9(b) and cannot be reconciled with, nor supported by, the language and structure of that section; (iii) that the argument of the Government completely misreads and misinterprets the purpose and effect of Section 9(c)(1) of the Act and is contrary to the explicit provisions of the Act, the contract between the parties and their stipulation; and (iv) that the legislative history not only does not support nor is it consistent with the Government's

view but is diametrically opposite to such theory and is consistent with Petitioner's contention and theory. For these reasons and for those advanced in Petitioner's original Brief, the judgment of the Appellate Court should be reversed.

Respectfully submitted,

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Proof of Service.

I, JOHN W. MCCONNELL, JR., the attorney of record for Petitioner herein and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 21st day of April, 1965, I served a copy of the foregoing Reply Brief of Petitioner by United States mail, postage prepaid, on each of the following attorneys of record for the United States of America and other interested parties at the offices indicated:

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